SOUTHERN CALIFORNIA SUNBELT DEVELOPERS, INC.

IBLA 97-348 Decided March 9, 1999

Appeals from separate decisions of the Palm Springs - South Coast Resource Area Manager adjusting the rental for right-of-way grants CA-14379 and CA-14632 and demanding back rental and royalty payments.

Set aside and remanded.

1. Appraisals--Federal Land Policy and Management Act of 1976: Rights-of-Way--Rights-of-Way: Appraisals

An increase in the annual rental charge for a right-of-way will be set aside and the case remanded for further consideration where an analysis of the record establishes that the BLM decision increasing the rental was in conflict with the underlying appraisal on which the new rental was putatively based and no adequate explanation for BLM's actions is provided.

APPEARANCES: Dan Baer, President, and Laura M. Reynolds, Administrator, Southern California Sunbelt Developers, Inc., for appellant; Julia Dougan, Field Manager, Palm Springs - South Coast Field Office, Bureau of Land Management, North Palm Springs, California, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE BURSKI

Southern California Sunbelt Developers, Inc. (SCSD), has appealed from separate decisions of the Palm Springs - South Coast Resource Area Manager, Bureau of Land Management (BLM), dated April 8, 1997, readjusting the rental for right-of-way grants CA-14379 and CA-14632. By Order dated July 3, 1997, we stayed implementation of these decisions pending substantive review by this Board. We now dissolve our stay, set aside the decisions appealed, and remand the case for further action as outlined below.

The rights-of-way involved had been issued for the purpose of producing and selling electricity generated from wind energy. 1/ Both rights-of-way had originated as part of right-of-way CA-13983 which had issued on

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1/ The history of these rights-of-way is set out in some detail in our recent decision in Southern California Sunbelt Developers, Inc., 147 IBLA

March 13, 1983, to Aztec Energy Corporation (Aztec). As originally issued to Aztec, Section B.7. of the right-of-way provided for an annual rental of $1,800 or 2 percent of the annual gross revenues received from the sale of electrical energy produced from the wind resources "if the annual rental payment is less than this royalty."

Effective September 9, 1983, a portion of CA-13983 consisting of certain lands within sec. 34, T. 3 S., R. 5 E., San Bernardino Base Meridian, aggregating 411 acres, was assigned from Aztec to Capco Financial Services (Capco) under serial number CA-14379. Section B.7. of this right-of-way provided for an annual rental of $5,918.40 (i.e., $14.40 per acre). It further provided that "In addition, the Holder shall pay the United States a royalty of two (2) percent of the annual gross revenues received from the sale of electrical energy produced from wind resources, if the annual rental payment is less than this royalty." Thereafter, another portion of CA-13983, this time consisting of lands within secs. 24 and 28, aggregating 761.74 acres, was assigned to Capco and serialized as CA-14632. This right-of-way provided for an annual rental of $10,969.06 (i.e., $14.40 per acre), and further provided, in language replicating the language used in CA-14379, for a royalty of 2 percent of the annual gross revenues received from the sale of electrical energy, "if the annual rental payment is less than this royalty."

Capco eventually assigned both rights-of-way to SCSD in 1986. It should be noted that, on November 16, 1991, SCSD relinquished sec. 24 of right-of-way CA-14632. This fact was apparently not reflected in BLM's records until relatively recently. 2/

By letter dated September 14, 1995, SCSD was notified that, based on requests by a number of wind energy right-of-way holders that BLM reevaluate the rentals and royalties which they were paying, BLM had decided to reappraise the fair market value of all wind energy rights-of-way. This letter further informed SCSD that BLM intended to contract with a third party to conduct this reappraisal and that SCSD would be assessed its pro rata share of the contract costs. By letter dated September 22, 1995, SCSD was advised that its apportioned cost of appraisal would be $16,150, with $7,550 attributed to CA-14632 and $8,600 attributed to CA-14632. 3/

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fn. 1 (continued)
266 (1999). We note that in our decision therein, we affirmed the determination of the Area Manager to terminate right-of-way CA-14379. This does not moot the instant appeal with respect to that right-of-way, however, since SCSD would be liable for past rentals through the date of termination.

2/ Whether this failure to correctly adjust for the decrease in acreage resulted in an overpayment of royalties is a matter subsequently analyzed in the text of this decision.

3/ While the record indicates that SCSD, after protest, ultimately paid at least $7,470 as costs for reappraising right-of-way CA-14632, we know of no regulation or statute which authorizes the assessment of holders of rights-of-way for costs attributed to the reappraisal of the value of a right-of-way.

Pursuant to contract, Stephen J. Herzog, an employee of Robert Ford & Associates, Inc., conducted an appraisal of BLM sites in the area of the San Gorgonio and Tehachapi Passes in southern California. On May 28, 1996, Herzog submitted his Appraisal Report. 4/ This document extensively reviewed both the historic development of and recent trends in the wind energy industry. A number of negative factors presently facing the industry were noted. Included among these were: the fact that a number of favorable contracts which wind energy producers had entered into with electrical utilities (normally referred to as Interim Standard Offer No. 4 or SO4 contracts) were expiring, which would likely result in a drastic diminution in income for wind projects; 5/ the determination of the Federal Energy Regulatory Commission (FERC) that the Biennial Resource Plan Update (BRPU) adopted by the California Public Utilities Commission (CPUC) in 1993, which had provided a major stimulus to the wind industry, violated

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fn. 3 (continued)

While the Board has, on one occasion, expressly authorized the assessment of an applicant for the costs associated with the initial appraisal of a right-of-way (see Diablo Communications, 128 IBLA 377, 380 (1994)), the Board is unaware of any decisional precedent or regulation which authorizes or even contemplates that holders of rights-of-way will be liable for costs associated with reappraising existing rights-of-way. To the extent that BLM attempted to justify this assessment as recoupment of monitoring costs, we note that not only do we not view such reappraisals as "monitoring" within the confines of 30 C.F.R. § 2808.4, but would also point out that that regulation clearly provides that monitoring costs will be recouped as a one-time fee prior to issuance of the right-of-way. See 43 C.F.R. § 2808.4(b) ("No right-of-way grant or temporary use permit shall be issued until the required payment is made").

We note, however, that SCSD did not appeal from assessment of these costs and this issue is not, therefore, properly before the Board.

4/ The Appraisal Report consists of initial sections covering both an industry overview and a generalized analysis of market data, aggregating 167 pages, numbered consecutively. This is followed by a section which individually appraises each of the BLM rights-of-way. Each evaluation is individually numbered. A final section, entitled "Final Conclusions," appears after the last BLM right-of-way appraisal and it is also individually numbered. The initial sections of the Appraisal Report will be cited as "Appraisal Report at _," the individual valuations will be cited as either "Appraisal of CA-14379 at _" or "Appraisal of CA-14632 at _," as appropriate, and the final section will be cited as "Final Conclusions at _."

5/ The SO4 contracts had generally provided for an escalating price paid per kilowatt-hour (kWh), starting at 5 cents in 1983 and increasing to as much as 14 cents per kWh by 1997. The duration of these initial purchase agreements, however, was 10 years and by 1995 many had begun to expire. In contrast, market forecasts for current prices were 4 cents per kWh for 1997, or less than 1/3rd the SO4 contract price. See Appraisal Report at 49-50.

FERC's "avoided cost" regulation; 6/ and, of particular impact, CPUC's subsequent ruling of December 20, 1995, providing a blueprint for the complete restructuring of the electrical utility industry in California. 7/

After detailing the existing economic conditions facing the wind energy industry, the appraisal individually analyzed various parcels of public land managed by BLM in the San Gorgonio and Tehachapi areas. Insofar as right-of-way CA-14632 was concerned, the appraisal first reviewed the history of the site and then concluded that the highest and best use of the land was for wind energy generation. See Appraisal of CA-14632 at 8. It is important to note, however, that notwithstanding the determination that the highest and best use of the property was for wind energy production, the appraisal expressly noted that:

> [N]ew commercial development of wind energy is not currently financially feasible. To my knowledge, it is not being privately developed at any location in California. However, when an existing power purchase agreement exists for a site, the situation is different. As indicated earlier in the report, these agreements are tied to a specific parcel and are therefore part of the real estate. There are no new power purchase agreements available which provide purchase prices for energy that make new development feasible. However, the prices in this pre-existing contract [are] sufficiently high [8/] so that, both new development and continued operation of the existing facility are feasible.

Id.

Turning to the valuation of the right-of-way, the appraisal chose the income approach in determining value. Id. at 9. While the appraisal noted that the lease comparables indicated a royalty range of between 2 to 7 percent of gross energy sales, the appraisal recommended a royalty

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6/ Southern California Edison (SCE) had challenged the BRPU on the grounds that it required payments to wind energy companies in excess of avoided costs (i.e., the costs the utility would have incurred had it purchased the electricity from another utility or generated the power itself). On Feb. 22, 1997, FERC upheld SCE's challenge on the ground that not all reasonable sources of generation had been considered in determining avoided costs.
7/ In brief, the CPUC ruling envisioned the establishment of a spot market pool for the generation of electricity (denominated as the Power Exchange) as well as an Independent System Operator for operation of the combined transmission assets in a single State-wide grid. The establishment of a spot market essentially makes the avoided costs (see note 6, supra), the spot market cost. Because costs associated with electric generation from wind energy are, at the present time, significantly higher than those associated with the generation of electricity from natural gas, this tends to place wind energy companies at a competitive disadvantage.
8/ The appraisal had earlier estimated that the prices paid per kWh were in the $0.04 to $0.05 range. See Appraisal of CA-14632 at 7.

of 3 percent of gross revenue, given the eroding market facing wind energy generation. Id. In recommending this royalty rate, the appraisal considered and rejected a flat annual payment based on installed megawatt capacity, arguing that conversion to a flat payment system would not be feasible until stable market conditions existed.

The appraisal also examined the question of establishing a minimum rent, noting that this was a particular "bone of contention" with a number of holders. Id. Pointing out that a tenant's underdevelopment or total failure to develop a site would negatively impact the Government, the appraisal concluded that minimum rent should be set close to but somewhat below the level of royalties that might be anticipated from full energy development. This would both protect the interests of the Government in obtaining fair value for the use of the land and provide an incentive to the lessee to maximize development of the right-of-way. The appraisal posited the following formula for determining the minimum rent:

Minimum rent = (The greater of installed capacity or capacity specified in power purchase agreement) x (8766 Hours per year) x (Capacity factor of 25%) x (3% royalty) x (Power sales price of $0.04 per kWh) x (75 percent)

Id. at 10. Applying this formula and assuming a 12,000 kW capacity, 9/ the appraisal concluded that the minimum rent for right-of-way CA-14632 should be $24,000 which equated to $2 per kW of installed capacity or $67 per acre. 10/ Id. at 11.

The appraisal of right-of-way CA-14379 generally tracked that of CA-14632 with one notable difference. While appraisal CA-14379 derived a minimum rent of $16,000 per year based on an 8,000 kW capacity (see note 8, supra), which equated to $2 per kW or $39 per acre, the CA-14379 appraisal also noted that, given the fact that this right-of-way no longer had any installed capacity, it might be appropriate to reduce the rental rate by

9/ This figure was derived from the fact that the site presently had 10,895 kW of installed capacity and was authorized to accommodate 12,320 kW of capacity. Furthermore, the appraisal noted that the power purchase agreement would allow the generation of an aggregate total of 20,000 kW from this site together with the lands within CA-14379. The appraisal accordingly allocated 12,000 kW of the total amount to CA-14632 and 8,000 kW to CA-14379.

10/ Though the Appraisal Report provided a per-acre computation of the minimum rent, the appraisal had expressly noted that rental arrangements where the payments were based on the number of acres involved were rare and that "in order to be equitable for both lessor and lessee, the payment for land use should reflect the capacity that can be installed and also the capacity factor that is attainable with competent management." Id. at 9.

50 percent during repowering of the site "but only if firm plans with a fixed time frame were presented." (Appraisal of CA-14379 at 10.)

After the appraisal had addressed each individual right-of-way evaluation, it turned to an issue which impacted the valuation of all of the sites, viz., costs related to site rehabilitation of the Federal lands. While admitting that the evidence from the private sector was inconclusive, the appraisal nevertheless noted that "where data was available on this topic, it appeared to indicate that the site rehabilitation requirements of the BLM are more stringent than in the private sector." (Appraisal Final Conclusions at 3.) The appraisal proposed a detailed 8-point plan for dealing with the problems of site rehabilitation, covering both the economic costs of compliance assumed by the holder and the desire of the Federal Government to assure itself that rehabilitation would ultimately occur. Of particular relevance herein was item 4, in which the appraisal noted:

> In an acknowledgement of the potentially higher demands for site rehabilitation security under BLM leases compared to the private sector, the following adjustments should be made. For the next five years, the minimum rent and royalty obligations should be adjusted downward by one-third. At the same time, an amount of money identical to this downward adjustment should be placed in a site rehabilitation trust account for that right-of-way. This account should be interest bearing with 30-year treasury bonds being the basis of interest calculations. In effect, the market rent will be considered to be one-third lower than expressed in the previous conclusions in this report regarding the individual right-of-ways. However, as a condition of benefiting from the lower rent, a mandatory site rehabilitation savings account must be maintained.

Id. at 4.

Following receipt of the appraisal, BLM contracted with another private appraiser, David J. Yerke, to provide an appraisal review. The November 1, 1996, Appraisal Review Report, which Yerke prepared, noted that, subsequent to the completion of the original appraisal, the State of California had adopted California State Assembly Bill No. 1890, which provided for the total restructuring of energy generation and delivery within California. While the appraisal review noted that some of the anticipated effects of this legislation had been considered in the original appraisal (see Appraisal Review Report at 13), it also suggested that the legislation, as adopted, was likely to negatively impact wind energy producers at a greater level than originally contemplated. 11/ See November 1, 1997, Cover Letter at 5. The appraisal review stated:

11/ While this bill adopted many of the principles originally contained in the CPUC blueprint, one major item which was seen as exacerbating the negative impact of the changes on the wind energy industry was the failure of the legislation to make specific provision for recovery of transition

> The restructuring process places wind energy resource commitments at a significant market disadvantage in terms of bidding future power costs to the pool. Additionally, the Assembly Bill does not provide assurance of a forward commitment to the wind energy component of the renewables as it does for each of the recited utility companies. Wind energy is left to compete with the major utilities not only in power cost pricing in the grid but also with all other "renewables" for the restitution provided for within the Bill.

Id.

Faced with the reality that the immediate economic outlook of the windpower generation industry was bleak, the appraisal review suggested that a royalty-based annual payment might prove counterproductive insofar as the continued viability of wind energy production, especially in the short-term, was concerned. Id. at 24-25. This conclusion was premised on an assertion that royalty-based payments might become so onerous as to cause abandonment of sites and a recognition of the costs absorbed by rights-of-way holders in maintaining production records and by BLM in reviewing these records for accuracy. Id. The appraisal review asserted that "the minimum rent formula established by the appraisal is the most credible method available now and for the foreseeable future." Id. While the appraisal review noted the "tremendous" costs of site rehabilitation as delineated in the original appraisal, it merely recommended that BLM adopt a plan of action similar to that outlined in the original appraisal. Id. at 26.

In a letter dated November 4, 1996, the original appraiser provided a brief follow-up analysis for the purpose of further examining a flat rate land-use payment by the holders of the rights-of-way. He noted that the "presumed" advantage of such a system would be the ease of administration. Assuming that BLM desired to utilize such a system, Herzog suggested that the only modification needed to his earlier formula would be to eliminate the final "75 percent." 12/ (Letter dated November 4, 1996, at 2.)

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fn. 11 (continued)
costs as they impacted the wind industry. Instead, wind energy producers were required to compete with all other renewables for the "restitution" provided under the legislation. Additionally, specific notice was taken in the appraisal review of the decline in the cost of gas-produced electric energy in recent years from 4 cents per kWh to between 2.5 cents to 3.0 cents per kWh (id. at 20) or, as it was later reported, to 2.0 cents per kWh (id. at 21).

12/ Use of the 75-percent figure had been originally justified on the ground that it provided a contingency allowance for factors beyond the holder's control. See, e.g., Appraisal of CA-14632 at 11. Why the change from a 3-percent royalty to a flat minimum justified deletion of this contingency allowance was unexplained either in the appraisal review or in Herzog's Nov. 4, 1996, letter.

Herzog pointed out, however, that "[a] flat rate payment structure does not address the site rehabilitation cost considerations discussed in the report." Id. at 3. 13/

By separate decisions dated April 8, 1997, SCSD was informed by BLM that, effective January 1, 1996, its rental payments had been raised to $31,558 per year for CA-14632 and to $21,038 per year for CA-14379. See Decisions dated April 8, 1997, at 2. These figures had been calculated based on the amended formula as suggested by Herzog in his November 4, 1996, letter.

BLM justified use of a flat base rent on four factors:

> 1. Since the rental formula was applied uniformly, all wind energy R/W holders would be treated fairly and equitably.
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> 2. By using a standard of operating at 25% of capacity, the formula provided an economic incentive to maintain equipment and operate efficiently.
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> 3. The government and the holder were not burdened with an end of year royalty reconciliation.
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> 4. Since the terms in the formula are fixed, the annual rent for the use of public lands would not change until the R/W was reappraised. [14/]

Id. BLM advised SCSD, however, that, even though there was no longer any need to conduct an end of year reconciliation, the holders of rights-of-ways were still required to submit power production/revenue reports.

BLM noted that, with respect to CA-14632, SCSD owed a total of $63,116 for the 1996 and 1997 rentals, less $5,484.50 that it had paid for estimated rental for 1996. BLM granted SCSD 30 days in which to tender the balance of $57,631.50. Insofar as CA-14379 was concerned, BLM informed SCSD that it owed $21,038 for 1996 and 1997 rentals, less $5,918 it had paid in estimated rent for 1996. BLM also granted SCSD 30 days in which to tender the balance on this right-of-way of $15,120. Upon receipt of these two decisions, SCSD filed the instant appeals. Together with its notices

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13/ Herzog also noted that "[f]or those sites not currently developed, a reasonable rental rate would be 8 percent of the value conclusion indicated in the appraisal," as opposed to the range of 8 to 10 percent which he concluded was properly applied to other sites.

14/ While BLM admitted that it had authority to reappraise rights-of-ways annually, it assured SCSD that it did not "expect to do so for several years, unless the terms in the formula change significantly." Id. BLM noted, however, that "a repowering which increased the installed capacity would justify recalculating the rent based on the new capacity." Id.

of appeal, SCSD requested that the Board stay implementation of the decision pending resolution of its appeal. By Order dated July 3, 1997, the Board granted this request.

In each of its original statements of reasons for appeal, SCSD challenged both the appraisal and BLM's authority to reappraise the rights-of-way at all. BLM responded by pointing out that it had express authority under 43 C.F.R. § 2803.1-2(d) (1983) to adjust rental fees "whenever necessary to reflect current fair market value," and generally argued that the appraisal fairly valued the subject properties. Before turning to these issues, however, it is necessary to take note of a problem which developed while the matter was pending before the Board.

By letter dated May 6, 1998, SCSD discussed on-going efforts to determine how much money, if any, SCSD owed BLM for payment of back royalties with respect to CA-14632. In this letter, SCSD raised three separate issues with respect to its past payments. First, it asserted that on two occasions (1993 and 1994) it had tendered both its annual rental payments and the full royalty without deducting the rental payments already made. Second, it noted that in 1994 it had computed royalties without excluding production generated from eight turbines located on private lands. Third, it noted that, despite the fact that it had relinquished sec. 24 in 1991, it had continued to be assessed for the acreage in that parcel through 1997. SCSD concluded that, because of the foregoing problems, BLM, in fact, owed SCSD $10,828.90 through calendar year 1998.

BLM responded by letter dated June 11, 1998. First of all, BLM asserted that there had been no overpayment of royalties in 1993 and 1994 because rent under the right-of-way was not deducted from royalties. Second, BLM refused to allow any credit with respect to energy production occurring from private lands because BLM was not responsible for this error and "it is not in the public interest to re-calculate prior royalties paid." Third, notwithstanding the foregoing statement, BLM agreed that SCSD had erroneously been charged with the acreage in sec. 24 and BLM provided a rental recalculation which adjusted for this error. Under BLM's calculations, SCSD owed BLM a total of $56,546 through calendar year 1998. 15/

SCSD took immediate issue with BLM's assertion that rentals were not to be deducted from royalties, pointing out that the right-of-way expressly provided that "[t]he difference in the amount of rent and royalty shall be due and payable annually on or before the 45th day after each anniversary date of this grant" and noting that BLM had, for over 12 years, calculated

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15/ The major source of this large discrepancy between the two figures was the fact that BLM disallowed any deduction for rent paid not only with respect to 1993 and 1994 but from 1992 through 1997. It should also be noted that these figures were computed under the old rental rates. Application of the new rental provisions would greatly increase SCSD's indebtedness.

the royalties after the fact, subtracted the rental payments already made, and invoiced the remainder. SCSD also challenged BLM's failure to allow any corrections with respect to energy production from private lands, noting that it was only seeking the rights which BLM, itself, frequently exercised to "go back as far in time as it wishes to correct mistakes in its favor." (Letter of June 24, 1998, at 2.) It concurred, however, in BLM's allowance of a deduction for overpayment of rentals based on the failure to adjust the acreage within the lease to reflect the elimination of sec. 24.

We recognize that this question of the amount of money, if any, owed by SCSD is not presently pending before the Board. Nevertheless, a full consideration of the issues which are before the Board necessarily requires that we address some of the issues involved in this most recent disagreement and we do so fully expecting that BLM will take our analysis into account in its future computations.

The relevant language of each of the rights-of-way involved herein provided first for a flat rate rental which worked out to $14.40 per acre and then provided as follows:

> In addition, the Holder shall pay the United States a royalty of two (2) percent of the annual gross revenues received from the sale of electrical energy produced from the wind resources, if the annual rental payment is less than this royalty. The difference in the amount of rental and royalty shall be due and payable annually on or before the 45th day after each anniversary of the above due date.

See, e.g., Section B.7.(b) of CA-14379.

Admittedly, the language of the provision is not a model of clarity and the fact that the royalty provision begins with the introductory phrase "in addition" certainly makes it susceptible to misinterpretation since it could be read as providing for a royalty rate added on to a flat rental rate. 16/ In point of fact, however, when construed in its entirety, this provision can only make sense if the language is interpreted as providing that the holder was required to pay a either a fixed rental of $14.40 per acre or 2 percent of the gross annual revenues, whichever was higher. This interpretation is not only consistent with the totality of the language found in this provision, it also accords with the consistent past construction of the provision by BLM as manifested in the record before us.

However, while we believe that SCSD is clearly correct in its assertion that, if 2 percent of its gross annual revenues exceeded the amount of money tendered as rental payments, these rental payments were, in effect, to be credited to its royalty obligations and, therefore, full

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16/ Indeed, the Board's Order of July 3, 1997, itself mischaracterized this language as providing for a fixed dollar rental "plus a royalty of two percent of the annual gross revenues." This interpretation is, as explained in the text of this opinion, erroneous.

payment of the 2-percent royalty in addition to its rental payment constituted an overpayment, SCSD has made a fundamental error in its assumption that the relinquishment of the land within sec. 24 had any necessary impact on the total amount of money it was obligated to pay. While it is true that SCSD's minimum rental obligation with respect to CA-14632 should have been lowered to reflect the decrease in acreage, the reality is that, in each year, SCSD would have been in royalty status because 2 percent of its annual gross was greater than even the erroneous minimum. Thus, except for those years in which its royalty obligations were simply not credited for the rental payments, no overpayment occurred based on the failure of BLM to eliminate the acreage in sec. 24. 17/

[1] Turning to the decision under challenge herein, a number of preliminary points may be made. Notwithstanding SCSD's assertions to the contrary, the regulations under which the instant rights-of-way were issued clearly provided that rental fees could be "readjusted whenever necessary to reflect current fair market value." 43 C.F.R. § 2803.1-2(d) (1984). Under such provisions, the authority of BLM to adjust right-of-way rentals to adequately reflect fair market value of the use of the land has been affirmed many times by the Board. See, e.g., Richard Campbell, 137 IBLA 280 (1997); Southern Pacific Transportation Co., 116 IBLA 164 (1990); James W. Smith, 34 IBLA 146 (1978).

In determining fair market value of nonlinear rights-of-way, the Board has also noted that the preferred method is the comparable lease approach, provided that there is sufficient comparable rental data and appropriate adjustments are made for differences between the subject site and other sites used for analysis. See, e.g., William J. Colman, 134 IBLA 375, 379-80 (1996); Michael D. Dahmer, 132 IBLA 17, 24 (1995). Finally, the Board has held on numerous occasions that a party challenging an appraisal determining fair market value is generally required to either show error in the methodology used in determining fair market value or, alternatively, submit its own appraisal establishing fair market value. See generally, Voice Ministries of Farmington, Inc., 124 IBLA 358, 361 (1992); High Country Communications, Inc., 105 IBLA 14, 16 (1988).

17/ For example, in calendar year 1994, SCSD tendered $10,969 in rental payments, even though it owed only $5,184 in rent, an overpayment of $5,785 insofar as rent was concerned. Its royalty obligation for that year (at 2 percent of its gross annual revenues), however, was $42,313.40. This is the total amount which SCSD owed, regardless of whether its rental was set at $10,969 or $5,184, because royalty at 2 percent was higher than the flat rate rental at either level. Since SCSD had already paid $10,969 in rent, it owed $31,344.40 in additional royalties based on the royalty assessment. This is the amount it actually paid. The only difference which would have occurred had the minimum rental been properly computed was that SCSD would have paid $5,184 in rental payments and $37,129.40 in royalty payments. While the components of its payment would have changed, the net payment would remain the same ($42,313.40). Thus, there was no overpayment (as SCSD argued) nor was there any underpayment (as BLM suggested) in calendar year 1994.

We note that, in accordance with the foregoing, the instant appraisal was essentially based on the comparable lease approach, utilizing a total of 17 leases of varying degree of comparability. See Appraisal Report at 157-64. The appraisal expressly rejected a rental determination based on a flat acreage rate instead opting for a 3-percent royalty rate underpinned by a minimum rental payment based on the generating capacity which could be installed under current power purchase agreements 18/ and applying a capacity factor which was attainable with competent management. See Appraisal of CA-14632 at 9. The appraisal also expressly rejected a flat payment based on installed megawatts, noting that, while "[i]n a stable market where high levels of certainty exist regarding production levels and energy prices, a flat rent could be set with equity for all parties, [t]he California situation hardly fits that description." Id. at 10.

The appraisal valuation ultimately adopted differed significantly from the foregoing. Thus, notwithstanding the appraisal's explicit repudiation of a flat rent based on installed capacity, the appraisal review and ultimately BLM chose precisely that approach. While there was a passing attempt in the appraisal review to suggest that this was done to ease the financial burdens placed on windpark operators (see Appraisal Review Report at 24-25), it seems clear to us that the primary, if not exclusive, impetus for this change was BLM's desire to simplify its collection of fair market value. 19/

Ease of administration is, of course, a valid consideration for BLM to weigh in determining the appropriate mechanism for assessing and collecting fair market value. But BLM's administrative convenience cannot be allowed to override the statutory requirement that the amount assessed must be said to fairly reflect the market value of the use permitted. And, in this instance, the amounts assessed with respect to CA-14379 and CA-14632 can simply not be said to represent fair market value for two discrete reasons.

18/ It should be noted, however, that while the appraisal referred to this item as "installed capacity," the figure used was not the actual capacity as it existed on either right-of-way but rather the amount of capacity which could be allocated to each right-of-way under existing power purchase agreements. In fact, however, while CA-14632 was assigned a figure of 12,000 kW of installed capacity and CA-14379 was assigned a figure of 8,000 kW of installed capacity, CA-14632 actually contained only 10,895 kW of capacity while CA-14379 contained none at all. See Appraisal of CA-14632 at 11; Appraisal of CA-14379 at 10.

19/ This point was underlined by Herzog in his Dec. 4, 1996, letter, where he noted that "the primary advantage of this system is perceived to be ease of administration." (Emphasis supplied.) And, it must be noted, that the theoretical advantage to the holders of a right-of-way which a flat rental system provides in easing administrative paperwork was totally vitiated by BLM's declaration that, notwithstanding the fact that rental would be determined by a flat rate, holders would still be required to submit power production/revenue reports.

First of all, in determining to switch from a minimum rent/royalty payment to a flat rent payment, BLM, in effect, simply increased the minimum rental recommended in the appraisal by 33 percent and utilized that figure as the annual required rental. 20/ This was done by eliminating the last item in the minimum rental formula (75 percent). There is, however, no justification in the record for this increase. As we noted above (see note 12), the 25-percent reduction which this figure represented was justified in the appraisal as a contingency allowance for factors beyond the holder's control. There is no explanation why switching to a flat rent eliminates the need for such an allowance.

More critically, the appraisal had expressly noted that rehabilitation costs were higher for all of the lands involved than they would be for non-Federally owned lands. To cope with these additional costs, the appraisal had suggested the establishment of site rehabilitation trust accounts initially funded by a one-third reduction in the annual royalty/rental payments for a 5-year period. No such provision was made in the BLM decisions under appeal.

We recognize that this recommendation was in the nature of a policy determination and that BLM was not obligated to endorse it. If BLM judged the proposal unwieldy or otherwise unworkable, it was free to reject it as it deemed appropriate. However, BLM was not free to ignore the problem which the appraisal had highlighted arising from higher costs attendant to the rehabilitation of BLM sites. Such disparate costs must, necessarily, be reflected in lower rents obtainable in the marketplace. If BLM elected to forego the establishment of private rehabilitation accounts, it was required to provide a downward adjustment in the rentals assessed in order to reach the true fair market value. 21/ This BLM did not do, and this failure fatally compromised the determination of the annual rental payments.

In view of the foregoing, we have no choice but to set aside the decisions appealed and remand the matter to BLM for further action. Moreover, we request that any re-analysis of fair market value address a point which we have found troubling in our consideration of this appeal. As our review of the record below makes clear, recent economic and political developments in California have dramatically depressed the economic outlook for wind power generation at these sites. So much so that the appraisal

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20/ Thus, while the minimum rent under the appraisal for all of the sites (with the exception of CA-26387, which had, at the time of the appraisal, more than 5 years left of SO4 contract pricing) was $2 per kW of installed capacity, the rent charged by BLM was $2.67 per kW.

21/ Once the appraiser determined that the costs of site rehabilitation on BLM lands exceeded those imposed for other lands, some adjustment in the rental assessed became necessary in order to fairly reflect the value that the BLM lease would have to a third-party, since, all else being equal, properties with higher inherent costs of operation are less attractive (and, hence, worth less) than those with lower costs of operation.

explicitly recognized that there was no realistic likelihood that any new development could occur within the foreseeable future since the prices which could be obtained for new sources of energy would be prohibitively low under the State of California's revised energy structure. See, e.g., Appraisal of CA-14632 at 8. This change in the economic outlook of the windpower industry has had the ancillary effect of lowering land values in the San Gorgonio area, land values which had previously been rising based on the possibility of using the land for wind power generation. Notwithstanding the above conclusions, in evaluating the highest and best use of the land, the appraisal determined that, in every case, the highest and best use of the land would be for wind energy production. This was justified on the ground that, even though no new commercial development of wind power could be deemed economically viable, the existence of in-place power agreements made wind energy production the highest and best use for these rights-of-way holders.

While we recognize the obvious reality that most of these rights-of- way are, in fact, producing wind energy, the unusual economic situation confronting the wind energy industry in California seemingly limits the ability to make the highest and best use to the specific holders who possess existing contractual arrangements. In other words, should SCSD abandon the energy field, the highest and best use of the land would no longer be energy production but rather would be lowered to reflect the land's low residual value as vacant land. Indeed, as the appraisal noted with reference to CA-14632, "[t]he physical characteristics, including the high wind present, make this site unattractive for alternate uses." (Appraisal of CA-14632 at 8.) What concerns us is the question whether, in effect, use of the land has been valued at its "special" value to existing users rather than at its value in the general marketplace. Such a valuation might be deemed a violation of a cardinal principle of appraisal. See generally, Exxon Corp., 106 IBLA 207 (1988); American Telephone & Telegraph Co., 77 IBLA 110 (1983). We think that this is a question which should be further explored in the re-analysis which we have ordered above.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the decisions appealed from are set aside and the case files remanded for further consideration consistent with the foregoing.

James L. Burski
Administrative Judge

I concur:

R.W. Mullen
Administrative Judge